Federal Government — indeed, his rather surprising contention was that the Cabinet action was purely a matter of Party discipline — I have given the question of costs special consideration and propose that the parties bear their own costs.

Application dismissed.

GOVERNMENT OF MALAYSIA v. GOVERNMENT OF THE STATE OF KELANTAN

[F.C. (Barakbah L.P., Azmi C.J. (Malaya), Ong Hock Thye F.J., Ismail Khan & MacIntyre JJ.) December 1, 1967]

[K.L. — Federal Court Special Reference No. X. 1 of 1967]

Constitutional Law — Financial provisions — Restriction on borrowing by State — Agreement between State Government and private corporation for grant of mining and forest concessions — Provisions for prepayment of royalties — Question whether such prepayment constituted a borrowing by State Government in violation of art. 112(2), Constitution of Malaysia — Question whether provisions for refunding prepayment would violate art. 97(2), Constitution of Malaysia and art. LVII of Kelantan State Constitution — Assignment of Revenue (Export Duty on Iron Ore) Act, 1962 and Assignment of Duty (Mineral Ores) Act, 1964 — Forest Rules under Kelantan State Enactment No. 4 of 1939, rr. 2 and 11 — Kelantan State Constitution, arts. LVII & LIX(1) — Constitution of Malaysia, arts. 97(2), 110(3), (3A) & (3B), 111(2) and 130 — Reference under art. 130 concerning arts. 111(2) and 97(2).

Article 111(2) of the Federal Constitution provides that a State shall not *borrow* except under the authority of State law, and State law shall not authorise a State to borrow except from the Federation or, for a period not exceeding 12 months, from a bank approved for that purpose by the Federal Government.

Article 97(2) provides that all monies and revenues howsoever raised or received by a State shall, subject to clause (3) and any law, be paid into the Consolidated Fund of that State.

Article LVII of the Kelantan State Constitution provides that no monies shall be *withdrawn* from the State Consolidated Fund unless they are (a) charged on such fund or (b) authorised by a State Supply Enactment.

By an agreement made on February 20, 1964 between the Kelantan State Government and the Timbermine Industrial Corporation Limited, it was provided by clauses 2 and 8 that the company should make prepayments of royalty for its mining and forest concessions which should be refunded by the State in the manner set out in detail therein.

The view of the Federal Government which was disputed by the State Government was that (a) the prepayment of royalties constituted a borrowing in violation of article 111(2) of the Federal Constitution and (b) that the refunding thereof would violate article 97(2) of the Federal Constitution and article LVII of the Kelantan State Constitution. Upon the questions in dispute being referred by His Majesty the Yang di-Pertuan Agong to the Federal Court for its opinion:—

Held: (1) upon considering the agreement as a whole, rather than the impugned clauses in isolation, there was no legal relationship of lender and borrower as between the company and the State Government, since "borrowing necessarily implies repayment at some time under some circumstances" and there was no liability to repay upon forfeiture for breach of conditions imposed on the company.

Dicta of Lord Davey in *N. E. Railway* v. *Hastings*,(2) of Somervell L.J. in *Inland Revenue Commissioners* v. *Rowntree & Co. Ltd.*,(3) and of Buckley J. in *In re Southern Brazilian Rio Grande do Sul Railway Company Ltd.*(1) applied.

Per Ong Hock Thye F.J.: "Since repayment of the monies advanced is not an essential feature of the transaction the conclusion becomes inevitable that the hallmark of a true borrowing is lacking. . . Indeed, such prepayments have been a common feature of mining agreements in Malaya, together with the forfeiture clause."

Per MacIntyre J.: "As far as I can ascertain, there is nothing in the State Enactment to prevent the executive authority of the State to prescribe, as a condition in a special licence, that a specified sum should be prepaid to account of royalty. Nor could such a condition be regarded as unbusinesslike or repugnant to public policy."

(2) the prepayment of $1,000,000 having been credited to the State Consolidated Fund, there was no breach of article 97(2) of the Federal Constitution, and there was no ground for supposing that further payments, if any, would not go similarly into that Fund.

Per MacIntyre J.: "The retention of the 50% by the company is not a refund out of the sum pre-paid and therefore the authority of a Supply Enactment is not required to retain money never paid into the Consolidated Fund."

Cases referred to:—

(1) *In re Southern Brazilian Rio Grande do Sul Railway Co. Ltd.* [1905] 2 Ch. 78, 83.

(2) *N. E. Railway* v. *Hastings* [1900] A.C. 260, 267.

(3) *Inland Revenue Commissioners* v. *Rowntree & Co. Ltd.* [1948] 1 All E.R. 482, 487.

FEDERAL COURT REFERENCE.

Mohamed Salleh bin Abas (Solicitor-General) and *Ibrahim bin Salleh* (Sr. Federal Counsel) for the applicant.

Thomas O. Kellock, Q.C., (*Dato' Wan Mustapha* and *Wong Kim Fatt* with him) for the respondent.

Cur. Adv. Vult.

Barakbah L.P.: I have had the advantage of reading the judgments of Azmi C.J. (Malaya), Ong Hock Thye F.J. and MacIntyre J. and I agree with them; but on account of the importance of the case I wish to say a few words. There is no doubt, despite the able arguments addressed to us by the learned Solicitor-General, that, reading the agreement as a whole the prepayment mentioned in clauses 2 and 8 of the agreement cannot be regarded as a loan.

The question under reference is whether article 111(2) and article 97(2) of the Federal Constitution are violated by clauses 2(a) and (b) and clauses 8(a) and (b) of the agreement dated 20th July, 1964. It was not disputed that to constitute a loan there must be an obligation to repay; there must be a money transaction and there must be a borrower and a lender.

Although a sum of money is involved and the word "refund" is mentioned in clause 2 of the agreement my opinion is that on considering the whole agreement they could not convey the meaning of a real loan and a real borrowing — see *Chitty* on Contracts (22nd Edition) page 259, paragraph 597. Furthermore, a loan is generally made with interest and it is significant to note that in this particular case although a very large amount of money is involved no interest is charged. There was also stated in clause 8(b) of the agreement the words "as security deposit which shall be forfeited to the State Government". A forfeiture clause, in my view, can never possibly arise in a loan agreement. Then again, the rest of the agreement would appear to confer a great deal of benefits to the State Government and therefore, reading the agreement as a whole, clauses 2 and 8 could not be construed to mean borrowing.

According to Mr. Kellock, counsel for the State Government, the money had been paid into the Consolidated Fund and the question of withdrawal had not arisen. Therefore the question of the payment into the Kelantan State Consolidated Fund in accordance with article 97(2) of the Federal Constitution does not arise. I therefore agree with my brother judges that the answers to both questions are in the negative.

Azmi C.J. (Malaya): This is a reference by the Yang di-Pertuan Agong under article 130 of the Federal Constitution, the substance of which has been published in the *Federal Gazette* as G.N. 3526 dated 18th August 1966. It arose out of an agreement made on 20th July 1962, between the State Government of Kelantan and the Timbermine Industrial Corporation Ltd. (hereinafter referred to as the company). This agreement was, however, subsequently amended on 6th November 1965.

The learned Solicitor-General who appeared for the Federal Government frankly admitted that he was not aware of this amendment and as a result asked us to give our answers to the questions posed by the Yang di-Pertuan Agong:—

(1) on the facts as contained in the original agreement,

(2) on the facts in the agreement as amended.

I do not consider it necessary or desirable that I should accede to his request.

I will therefore, consider this matter in the light of the subsequent amendment to the agreement.

The State Government under the agreement undertakes:—

(a) to give full authority to the company to enter upon land described in the schedule to the agreement for a period of 33 years for the purpose of exploiting, felling, logging and removing all utilisable timber and

(b) to grant prospecting permit and mining leases for all mineral (except oil shale or oil mineral) in the same specified area on condition that the company shall complete its prospecting over the said area within the period of three years from the date of issue of such permit.

Under clause 2 of the agreement the State Government undertakes to grant two mining leases to the company for which the company will pay the usual royalty but in addition thereto, the company will also pay a pre-payment of royalty a sum of one million dollars for each mining lease payable in two equal instalments of $500,000, the first to be paid on the date of the issue of the lease and the second six months later, or before the end of the year in which the first instalment was paid whichever should happen first.

In reference to this pre-payment the company is given an option to pay in lieu of the aforesaid payment a prepayment equivalent to one quarter of the estimated mineral deposit of the mining areas selected and applied by the company in two equal instalments in a manner abovestated provided however such prepayment should not be less than $250,000 in any case.

The State Government will wholly refund this pre-payment to the company from time to time at such an amount as and when received by the State Government from the Federal Government out of the royalty or export duty collected by the Federal Government from the amount in respect of which the said prepayment of royalty was made.

I think it is convenient to explain here that though under the Constitution revenue from mines belongs to the State (see article 110 and 10th Schedule Part III Item 2), clause (3) of article 110, provides that in case of tin produced in the State, the State shall receive 10% or such greater amount as may be provided in a Federal law and the export duty of tin so produced. And in reference to other minerals pursuant to the provisions of clause (3)(a) of the same article the Federal Parliament has under the Assignment of Revenue (Export Duty on Iron Ore) Act, 1962, and under the Assignment of Export Duty (Mineral-ores) Act, 1964, provided that a State shall receive in case of iron ore 10% of the export duty and in case of mineral ores, other than iron ore and tin ore 50% of the export duty produced in the State, in substitution for the royalty or similar charges normally collected by such State.

If I may now go back to the other provisions in the agreement dealing with mining leases first.

Clause 2(d) of the agreement requires the company to sub-lease any mining leases granted to them to a subsidiary company or companies in which not less than 45% of the issued capital shall be offered or reserved to Malays and for

this purpose the company has to grant loans to Malays to purchase 25% of the aforesaid capital at the official bank rate of interest prevailing at that time in the country.

Now to turn to the provisions in reference to timber. The company has to log not less than 20,000 acres in the first five years and 10,000 acres more in the next six years and within eleven years thereafter the remaining 40,000 acres.

Should the company fail to log the requested number of acres within the first five years or the acreage in the next seven years, the State Government shall be entitled to terminate the agreement and the company shall not have any claim or compensation for anything suffered or done by the company and any sum of money belonging to the company held by the Government in respect of various forms of payment as required by this agreement including any prepayment of royalty shall henceforth be forfeited to the Government.

Under paragraph 5(c) of the same clause it is also provided that the company shall employ Malays in number not less than 80% of its total unskilled employees in all works, factories and industries in the area and not less than 25% of the total employees or its subsidiaries in the skilled, technical and executive jobs, but this last provision shall be relaxed if such skilled, technical and executive personnel are not available for employment.

There was also provision requiring the company to award reasonable number of scholarships to not less than 3 at any time for higher education to Malays.

Under clause 8(a) the company shall pay a prepayment in respect of royalties to the State Government a sum of $1,000,000 on the signing of the agreement, and after three years from such date the State Government shall allow the company to set-off the aforesaid prepayment against the timber royalties becoming due and payable by the company to the Government from time to time at the rate of 50% of such royalties until the said prepayment has been repaid. When the aforesaid prepayment remaining in the hands of the State Government becomes less than $250,000 the company has to make another deposit as security and this is also subject to forfeiture, but will be paid back to the company on the due termination of the agreement.

The questions that we have to answer in this reference are as follows:—

(1) Does the payment by the company to the State Government of Kelantan of the so-called prepayment of royalties under clauses 2 and 8 of the agreement constitute a violation of the provisions of article 111(2) of the Federal Constitution because the arrangements relating to such payment constitute borrowing or loan and must therefore be —

(a) authorised by a Kelantan State Enactment; and

(b) made with the Federation or, for a period not exceeding 12 months, with a bank approved for that purpose by the Federal Government; and

(2) Does the refunding of the so-called prepayment of royalties to the company by collecting only 50% of the amount of royalties due from the company to the State Government of Kelantan and by setting off the other 50% in favour of the company until the so-called prepayment of royalties is fully and completely refunded violate the provisions of article 97(2) of the Constitution, because —

(a) the total amount of royalties due to the Government from the company is not paid to the Kelantan State Consolidated Fund in accordance with article 97(2) of the Federal Constitution; and

(b) the refund by setting off the other 50% in favour of the company is a withdrawal of money which is not authorised by any Kelantan Supply Enactment or any other Enactment in accordance with article LVII of the Kelantan State Constitution.

It was agreed by both parties that the true answer to the first question would depend on the answer to the question whether the State Government in accepting the prepayment of one million dollars or in agreeing to accept the prepayment in reference to the mining provision has borrowed the one million dollars or agreed to borrow the sum in reference to the mining provisions, within the meaning of the word in article 111(2) of the Federal Constitution.

Buckley J. in the case of *In re Southern Brazilian Rio Grande do Sul Railway Company Limited* [1] characterises "borrowing" as necessarily implying repayment at some time and under some circumstances. It was urged on behalf of the Federal Government that by reason of the extension of the meaning of the word "borrowing" in the Federal Constitution to include "the raising of money by the grant of annuities", it is intended that the word should be construed liberally, and it would therefore follow accordingly that in this case the prepayment which is to be paid back should be held to amount to a "borrowing."

Considered by itself, this prepayment of royalty by the fact that it is to be paid back, and paid back by instalments, a common method of repayment of a debt in this country, would at first sight give the impression that it is borrowing.

But in my view, it is essential that this court should consider all the provisions of the agreement as a whole. This agreement involves a big undertaking by the company. I have enumerated some of the things that the company must do under the agreement, and that this prepayment is subject to forfeiture for any breach of the agreement, for example, for failure to carry out any of the undertakings. When all these things are considered as a whole it looks to me correct to say that these prepayments are deposits for the due performance of the agreement by the company. In the circumstances I would come to the conclusion that these prepayments are not loans made by the company to the State Govern-

ment. The answer to the first question would therefore be in the negative.

Now in reference to the second question. It is alleged that the refunding of the prepayment of royalties to the company by collecting only 50% of the royalties due and by setting off the other 50% in favour of the company until the prepayment of the royalties is fully refunded has violated the provision of article 97(2) of the Federal Constitution because (a) the total amount of royalties due to the Government from the company is not paid to the State Consolidated Fund in accordance with article 97(2) of the Federal Constitution and (b) the refund by setting off the other 50% in favour of the company is a withdrawal of money which is not authorised by the Kelantan Supply Enactment or any other enactment in accordance with article LVII of the Kelantan State Constitution.

Article 97 of the Federal Constitution requires that all revenues and monies howsoever raised or received by a State shall, except in the case of Muslim revenue be paid into the Consolidated Fund of that State. We understand that the one million dollars which the State had received had in fact been paid into the State Consolidated Fund. This is confirmed by the Auditor-General in his report on the accounts of the State of Kelantan for the year 1964, and in reference to paragraph (b) of the second question no money as we understand had been paid by the company under the relevant clause so that this question would appear to be premature.

Ong Hock Thye F.J.: This is a reference to the Federal Court, under article 130 of the Federal Constitution, for its opinion whether the provisions of article 111(2) and article 97(2) of the Federal Constitution were violated by clause 2(a) and (b) and clause 8(a) and (b) of an agreement made on July 20, 1964 between the State Government of Kelantan and the Timbermine Industrial Corporation Limited, a company incorporated in Singapore, whereby the company was granted a permit to log, extract timber and forest products, to establish related factories and to prospect and operate mines in the District of Ulu Kelantan.

Article 111(2) of the Federal Constitution provides that a State shall not borrow except under the authority of State law, and State law shall not authorise a State to borrow except from the Federation or, for a period not exceeding 12 months, from a bank approved for that purpose by the Federal Government.

Article 97(2) of the Federal Constitution provides that all monies and revenues howsoever raised or received by a State shall, subject to clause (3) and to any law, be paid into and form one fund, to be known as the Consolidated Fund of that State.

Article LVII of the Kelantan State Constitution provides that no monies shall be withdrawn from the State Consolidated Fund unless they are —

(a) charged on the State Consolidated Fund; or

(b) authorised to be issued by a State Supply Enactment.

The legal advisers of the Federal Government took the view that the above articles of the Federal and State Constitutions had been contravened by clauses 2(a) and (b) and 8(a) and (b) of the said agreement. This view was strongly contested by the State Government and the conflict of opinions has now led to this reference by His Majesty the Yang di-Pertuan Agong. The relevant provisions in these two clauses are as follows:—

"2. The State Government undertakes to grant to the company or to its subsidiary companies, four (4) mining leases/certificates in the specified area over sites selected by the company (provided such sites be selected by the company within three (3) years from date hereof) on the following terms and conditions:

(a) That the company shall pay to the State Government in full the normal and usual royalty and such other levies or fees that may be fixed under the relevant laws.

(b) That the company shall pay a prepayment of royalty or otherwise a sum of dollars one million ($1,000,000) to the State Government for each mining certificate/lease but the State Government shall permit such payment to be made by two (2) instalments of dollars five hundred thousand ($500,000) each; the first instalment to be paid upon the date of issue of the lease and the second instalment on or before the expiry of six (6) months after such date or on or before the end of the year in which the first instalment was paid whichever is the earlier and the State Government shall wholly refund the said pre-payment of royalty to the company from time to time at such an amount as and when received by the State Government from the appropriate authorities out of the royalty or export duty collected by the appropriate authorities from the mine in respect of which the said prepayment of royalty was paid.

8.(a) The company shall pay a prepayment in respect of royalties to the State Government the sum of dollars two million ($2,000,000), by two (2) instalments of dollars one million ($1,000,000) each; the first instalment to be made upon the signing of this agreement and the second instalment to be made on or before the 31st day of December, 1964. And after three (3) years from the date of this agreement hereof (the company in the meantime paying the full rate of royalty) the State Government shall allow the company to set-off the aforesaid prepayment against the timber royalties becoming due and payable by the company to the Government from time to time at the rate of fifty per cent (50%) of such royalties until the aforesaid pre-payment has been wholly refunded.

(b) When the aforesaid pre-payment royalty remaining in the hands of the State Government becomes less than the sum of dollars five hundred thousand ($500,000) then the company shall deposit with or furnish to the State Government a cash amount or an approved banker's guarantee (renewable annually) of five hundred thousand dollars ($500,000) as

security deposit which shall be forfeited to the State Government on the termination of this agreement by the State Government in respect of any breach or non-compliance by the company of the terms and conditions as stipulated in this agreement. On the due termination of this agreement by affluxion of time or by the company in the manner provided in this agreement, the State Government shall refund or return to the company the said cash security deposit or bank guarantee."

The questions on which the opinion of this court is sought are:—

(1) Does the payment by the company to the State Government of Kelantan of the so-called prepayment of royalties under clauses 2 and 8 of the agreement constitute a violation of the provisions of article 111(2) of the Federal Constitution because the arrangements relating to such payment constitute borrowing or loan and must therefore be —

(a) authorised by a Kelantan State Enactment; and

(b) made with the Federation or, for a period not exceeding 12 months, with a bank approved for that purpose by the Federal Government; and

(2) Does the refunding of the so-called prepayment of royalties to the company by collecting only 50% of the amount of royalties due from the company to the State Government of Kelantan and by setting off the other 50% in favour of the company until the so-called prepayment of royalties is fully and completely refunded violate the provisions of article 97(2) of the Constitution, because —

(a) the total amount of royalties due to the Government from the company is not paid to the Kelantan State Consolidated Fund in accordance with article 97(2) of the Federal Constitution; and

(b) the refund by setting off the other 50% in favour of the company is a withdrawal of money which is not authorised by any Kelantan Supply Enactment or any other Enactment in accordance with article LVII of the Kelantan State Constitution.

Although I have not yet seen the judgments of my learned colleagues, I venture to express my opinion with little hesitation, even if it should turn out that I represent the minority view.

As to the contention that prepayment of royalties constitutes borrowing, the cardinal rule to be observed is that the contract must be considered as a whole. "Every contract is to be construed with reference to its object and the whole of its terms, and accordingly, the whole context must be considered in endeavouring to collect the intention of the parties, even though the immediate object of inquiry is the meaning of an isolated clause": see *Chitty* on Contracts (22nd Ed.) 597. As Lord Davey said in *N.E. Railway* v. *Hastings* [2] quoting Lord Watson:—

"The deed must be read as a whole in order to ascertain the true meaning of its several clauses, and the words of each clause should be so interpreted as to bring them into harmony with the other provisions of the deed if that interpretation does no violence to the meaning of which they are naturally susceptible."

It is not every raising of money that constitutes a borrowing. A case in point is *Inland Revenue Commissioners* v. *Rowntree & Co. Ltd.* [3] where Somervell L.J. said:—

"He (the Solicitor-General) sought to support that by a definition of lending, and he said that there is lending whenever a person makes or undertakes to make available for another person money which that other person subsequently has to pay back to someone. The answer I would give to that is that, in my view, that is not an accurate definition of lending. I think that the Solicitor-General's argument rather proceeded on the basis that any 'raising' of money must be regarded as a 'borrowing' of money. There I think it fails, and I agree with the learned judge, for the reasons which he gives, that Erlangers cannot be regarded as lenders. Nor do I think (and here I disagree with the learned judge) that the discount house can be regarded as lenders. It seems to me that this case brings out very well that there are two ways at least (there may be more) of raising money. One is by borrowing it and the other is by discounting a bill of exchange. They are both quite well known methods. One is borrowing and the other is discounting a bill. The fact that in many cases they produce the same result of providing financial resources for carrying on a business does not mean that words which are apt to describe one must be construed as covering the other."

In the same case Tucker L.J. also laid down, at page 485, that "there must be the legal relationship of lender and borrower" for the transaction to be construed as borrowing. Since the prepayment clauses should not be considered in isolation, as if they exist in a vacuum, it is necessary to look at the agreement as a whole to see if the other clauses support or rebut the contention of the Federal Government. In the first place, one is immediately struck by the fact that, contrary to the general rule in all cases of borrowing, not only is the Kelantan State Government relieved of the obligation to pay any interest, but other burdens are additionally imposed on the creditor company to do even more than laying out moneys free of interest, *e.g.*, the reservation of 45% of issued capital in mining and of 25% in forestry for Malays, loans to Malays for purchase of such shares, employment of Malays on the executive staff as well as labourers and even unto the provision of a reasonable number of scholarships, not being less than three at any one time, for Malays for higher studies locally and abroad. These are extraordinary terms in any contract, *à fortiori* in one said to be between borrower and lender.

In the second place, note should be taken of the fact that the prepayments are liable to forfeiture on breach of condition: see the proviso to clause 5(b)(i). This liability to forfeiture involves the necessary corollary that the contracting parties contemplated circumstances under which the moneys of the company in the hands of the Kelantan State Government would not have to be repaid at all. "Borrowing", said Buckley J. in *In re Southern Brazilian Rio Grande do Sul Railway Company Ltd.*, [4] "necessarily implies repayment at some time and under some circumstances". Since repayment of the monies advanced is not an essential feature of the transaction the conclusion becomes inevitable that the hall-mark of a true borrowing is lacking.

Indeed I see no distinction between the pre-payment of royalties in this case and advance payments made, for instance, by a prospective house-buyer to the builder in consideration of a special price, or again, pre-publication prices paid in advance for a book, which are generally at a substantial discount. In my opinion, the objects of the prepayment are clearly to ensure prompt and due performance by the company of their part of the agreement. There are no grounds whatsoever for imputing to the State Government any ulterior motive. Indeed, such prepayments have been a common feature of mining agreements in Malaya, together with the forfeiture clause. What holds good for mining agreements should be no less useful in agreements for the exploitation of forest produce. My answer to the first question, consequently is in the negative.

The second question is equally simple and admits of a short and ready answer. The monies have, I am told, been paid into the Consolidated Fund. There is no suggestion that further payments, if any, to be made would not similarly go into that fund. When the time for refund comes round there is no presumption that the State Government would not in due course do so in the manner prescribed by law. I accordingly agree with the submission of Mr. Kellock, Q.C. that the question does not arise. To put it more clearly, if a categorical answer is required, there has been no violation, in my opinion, of either article 97(2) of the Federal Constitution or article LVII of the Kelantan State Constitution.

Ismail Khan J.: The judgments just delivered by my brethren relieve me of the necessity of repeating the questions to which the answer of this court is sought.

I think the short answer to the first question is that the agreement must be considered as a whole. Clause 2(a) and (b) and 8(a) and (b) should not be construed as if they exist in a vacuum. If the court is required to read between the lines and to attribute ulterior motives to the Kelantan Government, such a contention must be supported by grounds which appear at least reasonable and probable. In consequence, the agreement must be allowed to speak for itself. Read in this light then, the agreement appears to me to be a genuine effort on the part of the State Government to encourage the development of the material resources of the State of Kelantan. In order to ensure that the projects are diligently and properly carried out, the prepayments were required as merely ancillary to the main purpose. On the other hand, it seems to me to be wholly farfetched to regard such prepayments as a borrowing without imposing an excessive strain on the commonplace meaning of the word as it is generally understood.

Even if in exceptional cases loans are given without interest, the essential feature of a loan is that the borrower must repay at some time or other. Where, as in this case, there are clear forfeiture clauses absolving the debtor in certain events of this duty to repay, there can be nothing in the argument of the learned Solicitor-General which persuades me against sound sense and everyday commercial practice to hold that the agreement is otherwise than what it purports to be *viz.* providing *inter alia* for prepayment of the value of State property to be extracted and recovered from State lands. The authorities for what constitutes in law a borrowing of money have been cited in the judgments delivered and I need not repeat them.

As to the second question, it is purely one of fact. No breach of the articles in the Federal or State Constitutions has been asserted as having taken place and these proceedings have not been instituted *quia timet.*

I am therefore entirely in agreement with my brethren that the answer to both questions is in the negative.

MacIntyre J.: This is a reference under article 130 of the Federal Constitution to determine two questions arising out of an agreement in writing dated the 20th day of February 1964, between the State Government of Kelantan and the Timbermine Industrial Corporation Limited (hereinafter referred to as the 'company'). Under the terms of clauses 2 and 8 of the agreement, the company undertakes to make prepayments of royalty in respect of certain mining and forest concessions, it being agreed that the "royalty or otherwise" so prepaid, be refunded out of the State Government's share of the export duty on minerals produced in the State by the company and collected by the Federal Government Authorities; and, in respect of the forest concession, by permitting the company, after the lapse of three years from date of prepayment (the company undertaking in the meantime to pay in full the royalties due) to retain by way of rebate 50% of the royalties thereafter falling due until the whole of the sum prepaid is refunded, subject to the right of the State Government to hold a sum of $500,000 out of the amount prepaid as a security deposit in respect of future payments of royalty unless replaced by a banker's guarantee.

The aforesaid clauses 2 and 8 of the agreement have been reproduced in the reference published under *Gazette* Notification No. 3526 of the 18th of August 1966 without taking note of the amendments and additions made to it in November 1965. The learned Solicitor-General, who appeared on behalf of the Attorney-General, urged that this court should ignore the amendments as otherwise the issues would be determined outside the scope of reference. The

amendments in this case, however, could be safely ignored not on the ground stated by the learned Solicitor-General but because they have not changed the basic character of the agreement.

To take the amendments to clause 8 first, they have the effect of reducing the amount to be prepaid to account of royalty in respect of the forest concession from $2,000,000 to $1,000,000 and of reducing the amount to be held as security deposit for $500,000 to $250,000. As for the amendments to clause 2, the number of mining leases to be granted by the State has been reduced from four to two and the period within which the company is entitled to select the mining areas has been extended from three to four years. A proviso has been added to clause 2(b) which reads as follows:—

"Provided always that the company shall have the option to pay (in lieu of the aforesaid prepayment) a prepayment of royalty equivalent to one-fourth (1/4) of the estimated mineral deposit of the mining areas selected and applied for by the company and such payment shall be made in two equal instalments in the manner hereinbefore stated, but notwithstanding anything contained in this proviso, the said prepayment of royalty shall not be less than two hundred and fifty thousand dollars ($250,000) in any case."

The two questions to be determined may be summarised as follows:—

(1) Does the prepayment of royalty as agreed constitute borrowing in violation of article 111(2) of the Federal Constitution which reads as follows:—

"A State shall not borrow except under the authority of State law, and State law shall not authorise a State to borrow except from the Federation or, for a period not exceeding twelve months, from a bank approved for that purpose by the Federal Government."?

(2) Does the right granted to the company to pay only 50% of the royalties due to the State and to retain the other 50% until the whole of the amount prepaid is refunded amount to a violation of the provisions of article 97(2) of the Federal Constitution which require all revenues raised or received by the State, subject to certain exceptions (not applicable to this case) to be paid into the Consolidated Fund of the State, having regard also to the fact that the right granted to the company to retain 50% of the royalties is a withdrawal of money from the Consolidated Fund which would require the sanction of a Supply Enactment before it could be paid out by virtue of the provisions of article LVII of the Kelantan State Constitution?

In regard to the first question, the court was urged on behalf of the Attorney-General, to regard the so-called prepayments of royalty under the provisions of clauses 2(b) and 8(b) of the agreement as loans advanced by the company to the State Government, because the transactions contain all the elements of borrowing, namely, there was a borrower and a lender, the transactions related to money, and there was a promise to repay. It was further contended, that having regard to the liberal definition of the expression 'borrower' in article 160 of the Federal Constitution; and having regard to the sources from which a State Government is empowered to receive or raise money, namely, from the sources enumerated in Part III of the Tenth Schedule to the Federal Constitution and to borrowing as provided under article 111(2) thereof, the prepayments must be regarded as monies borrowed since they do not fall under any of the items in Part III of the Tenth Schedule.

Another reason urged for regarding the provisions for the prepayment of royalties as a cover for borrowing money was that the State Government was not entitled to collect royalty on minerals mined in the State and in the case of forest produce was not entitled to prepayment in the circumstances of this case. It was pointed out that in respect of mining the State's right to collect royalty had been abolished by virtue of the provisions of article 110(3), (3A) and (3B) of the Federal Constitution and by virtue of the provisions of the Assignment of Revenue (Export Duty on Iron-ore) Act 1962 and of the Assignment of Export Duty (Mineral-ores) Act 1964; and in regard to forest produce, prepayment of royalty is restricted to fixed quantities of forest produce assessed in advance according to the prevailing rate or rates, by virtue of the provisions of rule 11 of the Forest Rules made under the Kelantan State Enactment No. 4 of 1939.

Article 110(3) of the Constitution reads as follows:—

"Each State shall receive, on such terms and conditions as may be provided by or under federal law, ten per cent or such greater amount as may be so provided of the export on tin produced in the State."

The implication of this clause is that the revenue from mines which by virtue of the provisions of clause (1) is allocated to the State will be limited in regard to tin produced in the State to a minimum of ten per cent of the export duty levied by the Federal Government and that the same shall be paid to the State on such terms and conditions and in such proportion as may be provided by an Act of Parliament. No Act of Parliament has yet been passed pursuant to this clause or clause (3B) in respect of tin. Under clause (3B) Parliament is empowered to enact laws prohibiting or restricting the levying of royalty or similar charges under a lease or other instrument or under the provisions of a State Enactment. Clause (3A) empowers Parliament to enact laws to provide the terms and conditions and the proportion of export duty which a State shall receive in respect of minerals (other than tin) produced in the State. By virtue of the provisions of this clause and of the provisions of the Assignment of Revenue (Export Duty on Iron-ore) Act 1962, the State Government's share of export duty on iron-ore

produced in the State was fixed at ten per cent and the levying of royalty under lease or other instrument or under the provisions of a State Enactment was declared illegal. Then under the provisions of the Assignment of Export Duty (Mineral-ores) Act 1964, which came into force after the execution of the agreement between the State Government of Kelantan and the company, the State's share of the export duty on minerals (other than iron-ore and tin) produced in the State was fixed at fifty per cent and the levying of royalties or similar charges by any of the aforesaid means by a State was declared illegal with retrospective effect, except with the consent of the Minister of Finance. To summarise the effect of these provisions of the Constitution and the aforesaid Acts of Parliament in regard to the right of a State to collect royalty on minerals produced in the State, the position is, that export duty on minerals is collected by the Federal Government and a proportion of it is assigned to the State. The right of a State to collect royalty in respect of minerals produced in the State had been abolished by Acts of Parliament except in the case of tin.

The argument that, because the State had no authority to collect royalties on minerals produced in the State, the transaction must be regarded as a loan cannot be sustained on that ground since the prepayment is not in respect of any royalty levied by the State but is in respect of the State's share of export duty which would lawfully accrue in the future. The question is whether the State is debarred by the provisions of the Constitution or of any Act of Parliament from obtaining payment in advance to account of its share or export duty as a condition precedent to the grant of a mining lease which is within its absolute discretion to issue? Article LIX(1) of the Kelantan State Constitution concedes to the State the power to acquire, hold and dispose of any property of any kind and to make contracts. A part of the export duty payable is the property of the State and the agreement deals only with that part. But even assuming that, in technical breach of the law, the State had entered into an agreement to obtain prepayment to account of its share of export duty, what this court has been asked to determine is not whether the agreement is valid in law but whether the prepayments amount to a loan within the meaning of article 111(2) of the Constitution. Borrowing is not to be proved by a process of elimination but by its special attributes. Buckley J. in *In re Southern Brazilian Rio Grande do Sul Railway Company Limited* [1] said as follows: "Borrowing necessarily implies repayment at some time and under some circumstances". I shall come to this question later.

In regard to payment in advance of royalty on forest produce, we were referred to rule 11 of the Forest Rules made under Kelantan State Enactment No. 4 of 1939 which reads as follows:—

> "Except as provided in rule 9, licences in Form II may be issued by or under the authority of the State Forest Officer to cut or collect and remove a fixed quantity of any forest produce on prepayment of royalty at the rate or rates laid down by or in accordance with rule 8."

This is not a provision of law prohibiting the collection by the State of prepayment of royalty but a provision laying down the conditions to be attached to a particular form of licence which a State Forest Officer is authorised by law to issue. We are not in the present case concerned in determining the rights of a licensor under a licence but are considering the effect of an agreement entered into by the State to grant a licence. The executive power of the State is exercised by His Royal Highness the Sultan-in-Council and the Forest Rules do not purport to fetter the power of the executive authority of the State to issue a licence in a form other than one prescribed under the Rules. This right is reserved under rule 2 of the Forest Rules which reads as follows:—

> "Except as provided in section 53 or otherwise in these Rules, no person shall —
>
> (a) fell, cut, ring, lop, tap or injure by fire or otherwise any tree on State land; or
>
> (b) cut, convert, manufacture or burn charcoal any timber on State land; or
>
> (c) cut, collect or remove any timber, firewood, charcoal, or other forest produce included in the royalty rate list published in accordance with rule 8,
>
> except, under and in accordance with the conditions of a licence in Forms I, II or III issued by a Forest Officer, or of licence in such other form and issued by such person as His Highness the Sultan may approve in any special circumstances or for any particular class of produce. No licence thus issued shall be transferable."

As far as I can ascertain, there is nothing in the State Enactment to prevent the executive authority of the State to prescribe as a condition in a special licence that a specified sum should be prepaid to account of royalty. Nor could such a condition be regarded as unbusinesslike or repugnant to public policy.

Mr. Kellock appearing on behalf of the State of Kelantan submitted that on a proper interpretation of clauses 2(a) and (b) and 8(a) and (b), the transactions could not be regarded as loans. The prepayments, according to him, were part and parcel of the contract by way of security. The prepayments were required:—

(1) As an incentive to the company to start work as soon as possible;

(2) As a deposit to constitute liquidated damages in case of breach; and

(3) As security for payment of royalties.

None of these functions, he said, could be construed as lending or borrowing. One of the characteristics of a commercial loan is the obli-

gation to pay interest. The prepayments under the agreement do not carry interest. If the prepayment under clause 8 was a loan then under no circumstances could it be forfeited to the borrower. Under clause 5(b)(i) of the agreement the prepayment of royalty in respect of forest produce could be forfeited if the company failed to carry out logging operations in the manner stipulated.

The nature of the transactions envisaged by clauses 2 and 8 of the agreement cannot be properly assessed if the clauses are considered in isolation from the remaining clauses of the agreement. It is a cardinal rule of interpretation that the meaning of a word, expression, phrase or sentence should be interpreted to conform with the purport and intent of the agreement taken as a whole. The agreement taken as a whole is aimed at raising revenue for the State. Under the terms of the agreement a part of the revenue to be raised has to be paid in advance, but the deal differs from an ordinary moneylending transaction in that the amount advanced would ultimately fall due to the State by way of revenue to be paid by the company directly or indirectly to the State. I am unable to distinguish the nature of this transaction from one in which money is advanced for services to be rendered or property to be purchased. The amount so advanced may have to be refunded if the consideration fails but that cannot alter the basic nature of the transaction which is neither borrowing nor lending.

Words and expressions should be given their ordinary meaning unless the context points otherwise. The phrase "prepayment of royalty or otherwise" in clause 2 of the agreement should be read to mean what it says; but the sentence: "The State Government shall wholly refund the said prepayment" should be read to mean "shall wholly account for the said prepayment". I am led to this conclusion by the fact that what is intended to be refunded is not the amount prepaid but an amount equivalent to the State's share of export duty on minerals subsequently collected by Federal Authorities and paid to the State. In other words, while in the case of a loan the amount advanced must be returned, in this case what is agreed to be returned is not the amount prepaid but the amount which would be overpaid to account of royalty. Therefore the *dictum* of Buckley J. would not apply to this transaction.

In regard to clause 8 of the agreement, it is quite clear that the amount agreed to be paid by the company to the State Government is partly a prepayment to account of royalty and partly a deposit by way of security for the due performance of the contract. For reasons which I have stated hereinbefore the State Government's power to lay down conditions for the grant of a licence is not exhausted by the Forest Rules by virtue of the provisions of rule 2. The argument that this transaction must be regarded as a loan transaction because the State had exceeded its authority in laying down the conditions agreed to under clause 8 of the agreement must therefore fail.

No evidence or admitted facts were placed before this court from which *mala fides* on the part of the State Government could be inferred. In the absence of evidence to the contrary, the *bona fides* of the parties to an agreement must be presumed. It must be presumed that in entering into this agreement there was no intention on the part of the State Government to act in violation of the provisions of the Constitution or of the laws. Applying this principle to the interpretation of clauses 2 and 8, and taking into consideration the true nature of the transactions, my answer to the first question under the reference is that the prepayments of royalty as provided under clauses 2 and 8 of the agreement do not constitute a violation of the provisions of article 111(2) of the Federal Constitution.

Before attempting to answer the second question, one fact must be taken note of. The sum of $1,000,000 to be prepaid to account of royalty under clause 8 of the agreement has been received by the State Government and credited to the State's Consolidated Fund as evidenced by the Financial Report of the State of Kelantan for the year 1964. Therefore when the company is allowed to pay 50% of the royalties that may fall due from time to time and to retain the other 50% until the whole of the amount prepaid is accounted for no question can arise of a failure on the part of the State Government to pay all the royalties due into the Consolidated Fund because the amount which the company is permitted to retain is covered by the prepayment which has already been paid into the Consolidated Fund. Again the retention of the 50% by the company is not a refund out of the sum prepaid and therefore the authority of a Supply Enactment is not required to retain money never paid into the Consolidated Fund. My answer then to the second question under the reference is, that the refunding of the prepayment of royalties to the company in the manner provided under the agreement will not violate the provisions of article 97(2) of the Constitution.

Both questions answered in the negative.

Solicitors: *Wan Mustapha & Co.*